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No. 93-1213

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

MANUFACTURERS HANOVER LEASING CORPORATION,
Petitioner,

v.

HAROLD G. LOWREY,
Trustee of Robinson Brothers Drilling, Inc.
and Robinson Brothers Drilling Company,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF AS AMICUS CURIAE OF THE AMERICAN BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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February, 1994

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In accordance with the provisions of Rule 37.2 of the Supreme Court Rules, the American Bankers Association hereby respectfully moves for leave to file a brief as amicus curiae in support of the Petitioner. Counsel for the Petitioner has consented to this filing; counsel for the Respondent has declined to consent.

The American Bankers Association is the principal national trade association of the commercial banking industry in the United States. As a representative of the industry, the Association has a distinct interest in preserving the rights and reasonable expectations of banks in having money lent by them repaid by their debtors, especially when the lenders have taken steps allowed by law to fortify those rights and expectations.

The decision of the Tenth Circuit in the case below (and of others that have adopted similar reasoning) allows use of the Bankruptcy Code to favor less careful creditors over more careful ones, whereas a sensible public policy would dictate the contrary result; the decisions do nothing whatsoever for a debtor, thus serving no public interest in a "fresh start" either.

Consequently, the decision below--the first in this lengthening line of cases to be petitioned to this Court--raises issues of great importance to the industry, and we respectfully suggest that the Court might benefit from a brief that discusses those issues from a perspective broader than that of the immediate parties to the case.

WHEREFORE, the American Bankers Association moves that leave be granted to file the attached brief as amicus curiae.

Respectfully submitted,

\s\

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QUESTION PRESENTED

Whether a trustee in bankruptcy can avoid a transfer made by a debtor to an outside creditor more than ninety days but less than one year before the date of bankruptcy where the antecedent debt for which the transfer was made was guaranteed by an "insider" of the debtor and that "insider" does not factually benefit from the transfer.

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BRIEF AS AMICUS CURIAE OF THE AMERICAN BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

INTEREST OF THE AMICUS CURIAE

The American Bankers Association is the largest national trade association of the commercial banking industry in the United States. It has members in each of the fifty

states and the District of Columbia, and its members hold over ninety percent of the assets of the United States commercial banking industry.

It belabors the obvious to state that commercial banks make commercial loans, and that they have some interest in having loans they make repaid. In furtherance of that interest, it is not unusual for banks to seek and receive multiple assurances that a loan will be repaid as a condition of granting it in the first place. Banks may take a security interest in the property and assets of the debtor which may be foreclosed in the event of default; they may insist upon guarantees of the debt by third parties; or they may do both. All such efforts to assure, in advance, that loans will be repaid are important to the safe and sound operation of the banks--always an important consideration. The decision of the lower court in this case and in others following the same line of reasoning, turns the fair, reasonable, cautious effort of banks on its head. It has the effect of making a bank's loan less secure with a personal guarantee than it would have been without the guarantee. That makes no practical or economic sense. We respectfully suggest that it makes no legal sense either.

REASONS FOR GRANTING THE WRIT

I.

THE DECISION OF THE COURT BELOW DOES VIOLENCE TO THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE AND IS THEREFORE AT ODDS WITH THIS COURT'S DECISION IN *U.S. v. RON PAIR ENTERPRISES*

The law governing preferences in bankruptcy is found

at 11 U.S.C. section 547(b). In full text, it provides as follows:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--
>
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made--
> (A) on or within 90 days before the date of the filing of the petition; or
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
> (5) that enables such creditor to receive more than such creditor would receive if--
> (A) the case were a case under chapter 7 of this title;
> (B) the transfer had not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

In this case, Manufacturers Hanover lent money to Robinson Brothers Drilling. The loans were to be repaid on a monthly or quarterly basis, and in fact some of the required payments were made by Robinson Brothers to Manufacturers Hanover during the period beginning one year prior to bankruptcy and ending ninety days prior to bankruptcy. The loans were personally guaranteed by one J. D. Hodges, the president and CEO of Robinson Brothers,

as well as the controlling shareholder. Mr. Hodges was, unquestionably, an "insider" of the Debtor. Equally unquestionably, Manufacturers Hanover was not. The Tenth Circuit has held that the payments in question by Robinson Brothers to Manufacturers Hanover were preferences and could be avoided by the Trustee, the Respondent in this case. *In re Robinson Brothers Drilling, Inc.*, 6 F.3d 701 (10th Cir. 1993). In addition, the court held, the preferences could be recovered from Manufacturers Hanover, though it is not an "insider" because it was the "initial transferee" under section 550(a)(1) of the Bankruptcy Code.[1]

This Court has made it entirely clear that in interpreting the Bankruptcy Code, as in other situations, "[t]he plain meaning of legislation should be conclusive, except in rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters." *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) (citation omitted). *See also Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988).

While the court below, and others adhering to the reasoning of the *Deprizio* cases, purport to follow the "plain meaning" of section 547, in point of fact, they deviate from that meaning in a number of key respects.

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[1] The Tenth Circuit's decision in this case is consistent with the holdings of three other circuits that have had occasion to deal with the so-called "trilateral preference" issue. *See In re Suffola*, 2 F.3d 977 (9th Cir. 1993), *In re C-L Cartage Co.*, 899 F.2d 1490 (6th Cir. 1992), and *Levit v. Ingersoll Rand Financial Corp.*, 874 F.2d 1186 (7th Cir. 1989) (hereinafter referred to as the *Deprizio* cases).

To begin, a transfer of property of the debtor to or for the benefit of a creditor, on an antecedent debt, made while the debtor was insolvent, may be avoided if it is made within ninety days before the date of the filing of the petition. 11 U.S.C. § 547(b). By negative inference, transfers made more than ninety days before filing are not avoidable. The ninety-day period is extended to one year if the creditor is an insider. In this case, it is undeniable that transfers of the property of the Debtor, Robinson Brothers, were made. It is undeniable that Manufacturers Hanover was a creditor of Robinson Brothers. It is undeniable that the payments were made on an antecedent debt. It is undeniable that the transfers of property were made to Manufacturers Hanover, and that the transfers were intended to, and did in fact, benefit Manufacturers Hanover. It is undeniable that the transfers were made more than ninety days before the filing of the petition. It is undeniable that Manufacturers Hanover was not an insider of the debtor. With all of those facts taken as givens, the discussion should come to an end: the transfers in question here are not avoidable.

Ignoring this set of facts, the court below focuses instead on the transfers made by the Debtor for the alleged benefit of the insider, Hodges (the very **same** transfers as those made **to** Manufacturers Hanover), holding that **those** transfers are avoidable and can be recovered from Manufacturers Hanover. Choosing the "insider" as the focal point of the court's attention in preference to the "outsider" makes it impossible to give effect to the "plain meaning" of the statute that protects a transfer to and for the benefit of an "outside" creditor made more than ninety days prior to the filing of a bankruptcy petition. There is nothing in the statute that directs the courts to focus on the "insider" rather

than the "outsider" in analyzing the issues presented here. Indeed, the statute suggests that it is error to do so.

First of all, in this case, as in the other *Deprizio* cases, it is easy enough to declare the guarantor an "insider," but far more difficult to find that the insider satisfies all of the tests set forth in section 547(b) to avoid a transfer. The transfer to or for the benefit of **a** creditor may be avoided if and only if the payment is "for or on the account of an **antecedent** debt owed by the debtor **before** such transfer was made." 11 U.S.C. § 547(b)(2). But here, Robinson Brothers clearly did not have an antecedent debt owed **to** the insider, Hodges, on account of which the transfers in question were made; did not owe anything to Hodges **before** the transfer was made. Any obligation by Robinson Brothers to Hodges could not arise, even contingently[2] until at least Robinson Brothers defaulted in its loan payments to Manufacturers Hanover, and not in reality until Hodges actually paid any of Robinson Brothers' debts to Manufacturers Hanover. The "antecedent" debt owed "before" the transfers was a debt owed not to Hodges but to Manufacturers Hanover, whereas this Court has held that "[p]reference implies paying or securing a pre-existing debt of the person preferred." *Dean v. Davis*, 242 U.S. 438, 443 (1917). In addition, under section 547, it is not enough that the transfer to a creditor be made on **any** antecedent debt more than ninety days and less than a year before filing of bankruptcy. Such a tranfer is avoidable only if **such** creditor is an insider. 11 U.S.C. § 547(b)(4)(B). A "creditor" is an "entity" that has a claim against the debtor" 11 U.S.C. § 101(10)(A). The law thus clearly ties the "antecedent" debt

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[2] *See* 11 U.S.C. §§ 101(12), 101(5)(A): a "debt" is a liability on a claim; a "claim" is a right to payment, whether or not contingent.

to a specific "creditor"--in this case, Hodges, not Manufacturers Hanover.

The same reasoning applies to section 547(b)(5). A transfer is avoidable only if "such creditor," here Hodges, receives more, by virtue of the transfer than "such creditor" (Hodges) would have received if the case were a Chapter 7 liquidation case and without the transfer. In point of fact, the guarantor "receives" less, not more, as a result of the transfers by the debtor to Manufacturers Hanover. Any claim that "such creditor" (Hodges) would have against Robinson Brothers would necessarily stem from his obligation, as guarantor, to pay Robinson Brothers' bills. The fact that Robinson Brothers made payments to Manufacturers Hanover reduced the contingent obligation that "such creditor" (Hodges) had on his guarantee from what that obligation would have been without the transfer. Since his contingent obligation was reduced, any claim he would eventually have against Robinson Brothers in a liquidation proceeding would be correspondingly reduced--dollar for dollar. The section 547(b)(5) test for avoidance is not and cannot be satisfied under the plain language of the statute.

Finally, section 547(b)(1) speaks of avoiding transfers made "to or for the benefit of a creditor." No transfer was made to Hodges. As a matter of economic reality,[3] the transfers that were made to Manufacturers Hanover did not benefit Hodges either. The transfers in question here totalled $175,000, and the court below holds that the transfers reduced Hodges' contingent liability in that amount.

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[3] In other contexts, this Court has given great weight to "economic realities" in construing statutory terms. *See, e.g., Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

But that is an entirely imaginary benefit. As the Tenth Circuit points out. Hodges' personal "negative net worth" was over $96 million. *Robinson Brothers*, 6 F.3d at 702. He will never, in fact, satisfy his guarantee; never, in fact, pay Manufacturers Hanover $175,000 worth of Robinson Brothers' bills or any part of it. Since he will never actually pay anyway, it is hard to see how telling him he does not have to really benefits him in any practical way. To find an actual benefit here is roughly akin to awarding a convicted felon a final, approved, unappealable sentence of six hundred years imprisonment, and then telling him he can receive up to one-third off for good behavior. The section 547(b)(1) test for avoidance is not satisfied here.

II.

THE DECISION OF THE COURT BELOW IS FUNDAMENTALLY INCOMPATIBLE WITH A DECISION OF THE FIRST CIRCUIT

In the preceeding section of this brief, we pointed out that the transfers to Manufacturers Hanover could not be avoided, under the plain language of section 547(b)(1) because they did not, in fact, "benefit" the "insider," Hodges. It is on this very point that the decision of the court below (and the other *Deprizio* cases) diverges from the decision of the First Circuit in *In re Erin Food Services, Inc.*, 980 F.2d 792 (1st Cir. 1992). In that case, the court refused to allow avoidance of a transfer of a debtors property to an outside creditor made more than ninety days but less than a year prior to filing of bankruptcy, even though the debt was guaranteed by an "insider."

The First Circuit itself takes great pains to downplay the difference in outcome between *Erin Food* and the

Deprizio cases, suggesting that they are distinguishable on their facts.

But they are not.

On a key analytical point, *Erin Food* is irreconcilable with the *Deprizio* cases. The First Circuit is unquestionably willing to consider the matter of "benefit" to the "insider" a question of fact (*Erin Food*, 980 F.2d at 801); the *Deprizio* cases invariably treat it as exclusively a question of law, automatically equating a mathematical or quantifiable monetary reduction in an insider's actual exposure with a "benefit" to the insider, even where the guarantor is overwhelmingly insolvent.[4]

The difference between the two forms of analysis have real-world consequences, and this Court should grant certiorari in order to choose which analysis is the correct one.

In the case below, the insider, Hodges, simply personally guaranteed the debts of Robinson Brothers to Manufacturers Hanover, without apparent limitation. In *Erin Food*, the insider pledged certain of his property, on a non-recourse basis, to secure Erin Food's debt. The amount of the debt exceeded $61 million, the "transfers" sought to be avoided by the trustee totalled $2.08 million, and the value of the pledged property was found to be $19.35 million. The court found that under these facts there was no "cognizable benefit" to the insider. His total exposure was the value of the pledged property, both before and after the transfers. The court reached this conclusion despite the

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[4] *See, e.g., Robinson Brothers*, 6 F.3d at 702; *In re Suffola*, 2 F.3d 977, 985 (9th Cir. 1993).

argument by the Trustee that the guarantor was potentially liable for the full $61 million indebtedness of Erin Food. The guarantor's greater potential liability could have been triggered by a substantial future increase in the value of the collateral. Still, the First Circuit concluded that

> This argument too is flawed....It is not enough that the trustee show that the value of the pledged collateral might have fluctuated during the ensuing period prior to bankruptcy. Moreover, the trustee presented no evidence that the collateral securing either Erin's debt or Murray's guarantee fluctuated during the year before bankruptcy.

Erin Food, 980 F.2d at 802 n. 17.

Thus, to the First Circuit, a mere theoretical possibility that, at some future point, the reduction in a guarantor's exposure might retroactively be found to benefit the guarantor is insufficient to satisfy the section 547(b)(1) test. By contrast, the Tenth Circuit finds nothing to suggest

> that the otherwise undeniable economic benefit represented by an actual reduction in pecuniary liabilities somehow disappears simply because the beneficiary remains insolvent following the reduction....[W]e refuse to graft a solvency condition onto the creditor-benefit requirement plainly stated in the statute.

Robinson Brothers, 6 F.3d at 703.[5]

Yet a "solvency condition" is precisely what the First Circuit did impose on the pledged property in *Erin Food*. The value of the property was grossly insufficient to satisfy the guarantee (although that condition was not inherently permanent), just as the value of Hodge's assets here are grossly inadequate to satisfy his guarantee. The transfer of even a considerable sum of the debtor's money to an outside creditor did not make it any more likely that the assets standing behind the guarantee would be able to satisfy the guarantee in *Erin Food* than it does in this case. The First Circuit, therefore, finds no factual benefit to the guarantor, and no avoidance of the transfers. The Tenth Circuit, on the other hand, finds a "legal" benefit and allows avoidance. Both cannot be correct interpretations of the same law.

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[5] *See also In re Suffola*, 2 F.3d at 986 ("Insolvency is transitory, or at least not inherently permanent. A decrease in insolvency, like an increase in the degree of solvency, is beneficial.").

CONCLUSION

For all of the reasons stated herein and in the Petition for Writ of Certiorari, the American Bankers Association, on behalf of its member banks, hereby respectfully urges the Court to grant the Petition.

Respectfully submitted,

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